INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:

Cleveland Trust Co. v. *Commissioner*, 115 F. 2d 481, certiorari denied, 312 U. S. 704	8
Commissioner v. *Brouillard*, 70 F. 2d 154	7
Commissioner v. *Gibbs-Preyer Trusts Nos. 1 & 2*, 117 F. 2d 619	7, 8
Dunbar v. *Commissioner*, 65 F. 2d 447	7
Gardiner v. *United States*, 49 F. 2d 992	7
Helvering v. *Coleman-Gilbert*, 296 U. S. 369	6
Helvering v. *Combs*, 296 U. S. 365	9
Kilgallon v. *Commissioner*, 96 F. 2d 337, certiorari denied, 305 U. S. 622	9
Lewis & Co. v. *Commissioner*, 301 U. S. 385	8
Little Four Oil & Gas Co. v. *Lewellyn*, 35 F. 2d 149	7
Morrissey v. *Commissioner*, 296 U. S. 344	6, 9, 10
Nashville Trust Co. v. *Cotros*, 120 F. 2d 157, corrected, 122 F. 2d 326, certiorari denied, 314 U. S. 680	9
Pennsylvania Co. for Insurances, etc. v. *United States*, 138 F. 2d 869, certiorari denied, 321 U. S. 788	9
Swanson v. *Commissioner*, 296 U. S. 362, affirming 76 F. 2d 651	10
Tyson v. *Commissioner*, 54 F. 2d 29	7
Willis v. *Commissioner*, 58 F. 2d 121	7

Statutes:

Internal Revenue Code:

Sec. 161 (26 U. S. C. 1940 ed., Sec. 161)	10, 11, 12
Sec. 162 (26 U. S. C. 1940 ed., Sec. 162)	10, 12
Sec. 3797 (26 U. S. C. 1940 ed., Sec. 3797)	14

Miscellaneous:
Page
Treasury Regulations 103:
Sec. 19.161–1 14
Sec. 19.3797–1 15
Sec. 19.3797–2 15
Sec. 19.3797–3 16
Treasury Regulations 111:
Sec. 29.161–1 19
Sec. 29.3797–1 19
Sec. 29.3797–2 19
Sec. 29.3797–3 19

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 439

C. C. FLETCHER AND E. E. WAKEMAN, AS SURVIVING TRUSTEES OF THE STANDARD BENTONITE COMPANY, A TRUST, PETITIONERS

v.

FRANK G. CLARK, AS COLLECTOR OF INTERNAL REVENUE FOR THE COLLECTION DISTRICT OF WYOMING

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the District Court (R. 16–28) is reported at 57 F. Supp. 479. The opinion of the Circuit Court of Appeals (R. 89–93) is reported at 150 F. 2d 239.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 5, 1945 (R. 93), and an order staying mandate was issued on July 24, 1945 (R.

94). Petition for a writ of certiorari was filed on September 20, 1945. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals properly held that the so-called trust, here involved, is an association taxable as a corporation within the meaning of Section 3797 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 12–19.

STATEMENT

The facts taken from the District Court's memorandum opinion (R. 16–22) and from its findings of fact (R. 22–28) may be stated as follows:

C. C. Fletcher and seven others were the original locators of six placer mining claims. (R. 22–23.) Transfers of interests in the claims were made by the locators through C. C. Fletcher as attorney in fact. By October 31, 1929, there were 18 owners. (R. 23.) The interests were not of equal value. In order to equalize their interests and to provide for the handling of the entire group as a single tract the 18 owners decided to form a trust. The trust was formed by a trust deed and agreement on October 31, 1929. It speci-

fied that in order to "combine their separate interests in the * * * claims, so that each * * * [might] have and hold a beneficial interest in the entire group" and "for convenience in handling and operating" the claims, the individual owners by the deed created "an unincorporated association." (R. 23.) The association was to be known as, and to "do business" under the name of Standard Bentonite Company. (R. 23, Ex. A. R. 6.) Trustees were to hold title to and represent the interests of the beneficiaries "in all matters concerning the claims." (R. 17.) A provision followed by which the 18 owners quit-claimed to the designated trustees, C. C. Fletcher, L. F. Fletcher, and E. E. Wakeman, and their successors in trust, all of their "interest" in the six claims. (R. 23–24.)

Further provisions empowered the trustees (R. 24)—

> to manage and control * * *, to negotiate for the sale of and to sell, or to lease, to incumber, to contract for the development of, to mine upon, operate and develop * * *, or to otherwise handle or dispose of the * * * property, or any part thereof, to whom and upon such terms as the said trustees * * * [might] deem best * * *

They were also appointed attorneys in fact for "each of the parties * * * or their successors

in interest," and were given full authority to (R. 24)—

> execute any and all deeds, leases, contracts or other instruments affecting title to the * * * lands in their names as trustees * * * without naming any of the * * * holders of beneficial interest, * * * as grantors, lessors, or parties to any such deeds, leases, contracts or agreements.

Surviving trustees, in the event of the death, disqualification, or resignation of any of the trustees, were to have full power to act and to appoint a successor with the "approval of the holders of the majority of the beneficial interests in the trust." (R. 17.)

Provision was also made for the issuance of certificates of beneficial interest to the persons creating the trust in specified undivided fractional interests with rights to a proportionate share in the profits. (R. 17, 24, 25.) The interests were to be transferable by "instrument of assignment executed in the manner required for the execution of deeds." (R. 24–25.) By a further paragraph the owners of beneficial interests undertook to contribute a pro rata share to the expense of annual assessment work upon the claims and agreed that the trustees should be entitled to sell and dispose of such portions of the interest of a defaulting owner as should be necessary to raise his pro rata share. (R. 25.) The

agreement was made binding upon heirs, executors and assigns, and the duration of the trust was limited to 25 years. (R. 25.)

During the years 1929 to 1940 the taxpayers engaged in no activity except the performance of the assessment work necessary to hold the six claims. (R. 26.) Transfers of interests were made by the beneficial owners in accordance with the provisions of the trust deed and agreement. (R. 25.)

In 1940 the trustees executed four contracts for the sale of bentonite. Three of these — with Messrs. Messersmith and Materi, B. H. Thoeming, and Webster—provided for the sale of specified tonnage of bentonite in place at a specified rate per ton as mined. The trustees were required to remove the overburden and the vendees to perform the mining. The fourth agreement sold to the Wyodak Chemical Company "all of the merchantable deposits of bentonite" under a certain described area of the claims, payments to be made $20,000 upon signing of the contract, $15,000 on August 1, 1941, and $5,000 on August 1, 1942. (R. 26.)

In 1941 the trustees sold 60 acres of the land constituting the corpus of the trust to B. H. Thoeming for approximately $16,000. (R. 26.) And in 1942 they sold to B. H. Thoeming for approximately $24,000 part of claims 1 and 2 out of the corpus. (R. 26–27.) All of the remaining

corpus of the trust was sold to the Wyodak Chemical Company on August 6, 1942, for $225,000 (R. 27), to be paid $25,000 upon the execution of the agreement, $34,000 a year to 1948, and $30,000 on July 1, 1948 (R. 61–62). By a written instrument the beneficiaries indicated their approval of the contract. (R. 27.)

The Commissioner assessed deficiencies in income and personal holding company taxes, aggregating $25,926.52 (R. 16), for the years 1940, 1941 and 1942, which amount was paid by the taxpayers (R. 22). Both the District Court and the Circuit Court of Appeals approved the Commissioner's determination, holding that the Standard Bentonite Company was taxable as an "association" within the meaning of Section 3797 of the Internal Revenue Code.

ARGUMENT

The court below, affirming the District Court and the Commissioner, correctly concluded that the trust here involved was an association taxable as a corporation under Section 3797 of the Internal Revenue Code and the applicable Treasury Regulations (Appendix, *infra*). It properly applied the principles stated by this Court in *Morrissey* v. *Commissioner,* 296 U. S. 344, 361, that the character of an organization is to be determined by the terms of the trust instrument, and in *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369,

374, that the parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument.

Petitioners assert that the decision below conflicts with that of the Sixth Circuit Court of Appeals in *Commissioner* v. *Gibbs-Preyer Trusts Nos. 1 & 2,* 117 F. 2d 619, as to the application of the above stated principles. The statement made by that court to the effect that the test, in determining whether a trust is an association, must be found in what the trustees actually do [1] rather than in the existence of unused powers, must be viewed in the light of the peculiar facts in that case and the actual basis of the court's decision.

In the *Gibbs-Preyer* case, the Board of Tax Appeals had found as a fact that there was a contemporaneous oral agreement between the parties to the written trusts to the effect that where the properties involved were managed by members

[1] In support of its statement the court cited (p. 623) *Gardiner* v. *United States*, 49 F. 2d 992 (C. C. A. 1st); *Dunbar* v. *Commissioner*, 65 F. 2d 447 (C. C. A. 1st); *Little Four Oil & Gas Co.* v. *Lewellyn*, 35 F. 2d 149 (C. C. A. 3d); *Tyson* v. *Commissioner*, 54 F. 2d 29 (C. C. A. 7th); *Willis* v. *Commissioner*, 58 F. 2d 121 (C. C. A. 9th); and *Commissioner v. Brouillard*, 70 F. 2d 154 (C. C. A. 10th). All of these cases were decided before this Court's decision in the *Morrissey* case, and as the court below stated (R. 93) in speaking of its own decision in the *Brouillard* case "it is no longer controlling on the question." Although the statement in the *Gibbs-Preyer* case was wholly incorrect, as a general principle, application for certiorari was unwarranted in view of the real basis of the decision.

of the family or beneficiaries, such persons would be considered as agents of the beneficiaries of the trusts, and that the properties had been consistently so managed. The Circuit Court of Appeals decision was actually based upon the theory that the terms of the written instrument, as to the trustee's powers, were not intended to and did not become operative so long as the properties were managed by members of the family or beneficiaries. The trustee's duties were purely ministerial. There is therefore no conflict between the *Gibbs-Preyer* decision and the decision below, nor with *Cleveland Trust Co.* v. *Commissioner,* 115 F. 2d 481 (C. C. A. 6th), certiorari denied, 312 U. S. 704, which is also distinguishable upon its facts.

Nor is the decision below in conflict with *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. The different result in that case is also accounted for by the facts there involved, which distinguish it from the instant case. "The duties of the trustee were purely ministerial, with *no power* to control, direct, or participate in, the conduct of the selling enterprise contemplated by the contract." (Italics supplied, pp. 388–389.) Furthermore, since there was but a single beneficiary, there were no "associates" in that case.

While the petitioners assert (Pet. 3, 8) a probable conflict with the *Morrissey* case, they do not deny that the Standard Bentonite Company was

the result of an agreement whereby a number of individuals combined together in an "unincorporated association" for the purpose of realizing greater profits from the exploitation of mining claims by a pooling of individual interests. There is abundant evidence in the record of the commercial character of this enterprise which establishes clearly its role as a profit-making medium, rather than as a traditional trust, primarily intended for the conservation of property. The essential attributes of this trust closely resemble those of the corporate form enumerated in the *Morrissey* decision—the ownership, management and control of the property is centralized; the continuity of the trust is not affected by death among the beneficial owners or the trustees; interests were represented by transferable certificates of beneficial ownership.

As the court below pointed out (R. 92), the failure of the trust instrument to provide for limitation of personal liability of participants is not a conclusive factor, as was shown in *Pennsylvania Co. for Insurances, etc.* v. *United States,* 138 F. 2d 869 (C. C. A. 3rd), certiorari denied, 321 U. S. 788; *Nashville Trust Co.* v. *Cotros,* 120 F. 2d 157, corrected, 122 F. 2d 326 (C. C. A. 6th), certiorari denied, 314 U. S. 680; and *Kilgallon* v. *Commissioner,* 96 F. 2d 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622. See, also, *Helvering* v. *Combs,* 296 U. S. 365, where this Court re-

ferred to the limited liabilities of the associates although no express limitation of liability was shown by the record.

The fact that the certificates of interest, in this case, were transferable only by execution of a separate instrument, is immaterial, for, as stated in the *Morrissey* case (p. 358) "the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer."

Sections 161 and 162 of the Internal Revenue Code (Appendix, *infra*) are not applicable to this trust. Those sections and the Treasury Regulations interpreting them make it clear that they are not intended to embrace a trust created by the beneficiaries for the conduct of a business enterprise. Petitioners' assertion (Pet. 7) that "the income of a *true trust actually from property held in trust could not, because of Section 161 (a)*, be taxed as that of an association," obviously begs the precise question here involved, for both the District Court and the Circuit Court of Appeals held that this was not a true trust.

Finally, contrary to petitioners' contention (Pet. 6) this Court has passed upon the character of a trust in a case similar to the present one. In *Swanson* v. *Commissioner,* 296 U. S. 362, affirming 76 F. 2d 651, 653 (C. C. A. 7th) (a companion case to *Morrissey* v. *Commissioner, supra*), the taxpayers' contention was that the income of a trust

was taxable under Section 219 of the Revenue Act of 1926, which is comparable to Section 161 of the Internal Revenue Code. In that case active management of the property was not carried on by the trustees as such, but was turned over to a trustee acting in another and different capacity. Nevertheless, this Court held the trust taxable as an association.

CONCLUSION

The decision of the court below is correct; there is no conflict; no question is involved upon which this Court has not passed. The petition for a writ of certiorari should be denied.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ROBERT N. ANDERSON,
MURIEL S. PAUL,
Special Assistants to the Attorney General.

OCTOBER 1945.